

## ARTICLE

# Founder-Owned Companies: How to Capture Value More Rapidly

By Gary Hoover and Ranjith Rajendran  
APR.16.24

## Key Takeaways:

- **Private Equity Interest in Founder-Owned Companies is Rising:** Founder-owned businesses are not only viable but often superior targets for private equity investments, especially given their potential for higher revenue and EBITDA growth.
- **Challenges and Opportunities in Leadership and Organisational Change:** Founder-owned businesses often require a tailored approach to leadership restructuring and management changes. PE firms need to engage carefully, balancing the introduction of new management systems and leadership while maintaining trust and continuity, which are crucial for facilitating successful transitions and achieving rapid growth.
- **Strategic Improvement and Capacity Building Are Essential:** PE firms must focus on aligning interests, building institutional knowledge, and enhancing operational efficiencies to unlock the full potential of these businesses. This involves not only identifying and overcoming resistance to change but also implementing robust training and development programmes to sustain long-term growth.

**Founder-owned companies can make attractive private equity targets but getting them towards a lucrative exit requires a different approach from that in other types of business. So how can firms understand what they are buying and ensure these companies reach full growth and value creation potential?**

Private equity firms are increasingly turning to deals involving founder-owned companies as value creation through operational improvement has taken centre stage over recent times. Over 56% of US private equity deals in Q4 2023 involved non-backed targets (the majority of which are founder-owned businesses), up from 45.5% in Q1 2021, according to Pitchbook.

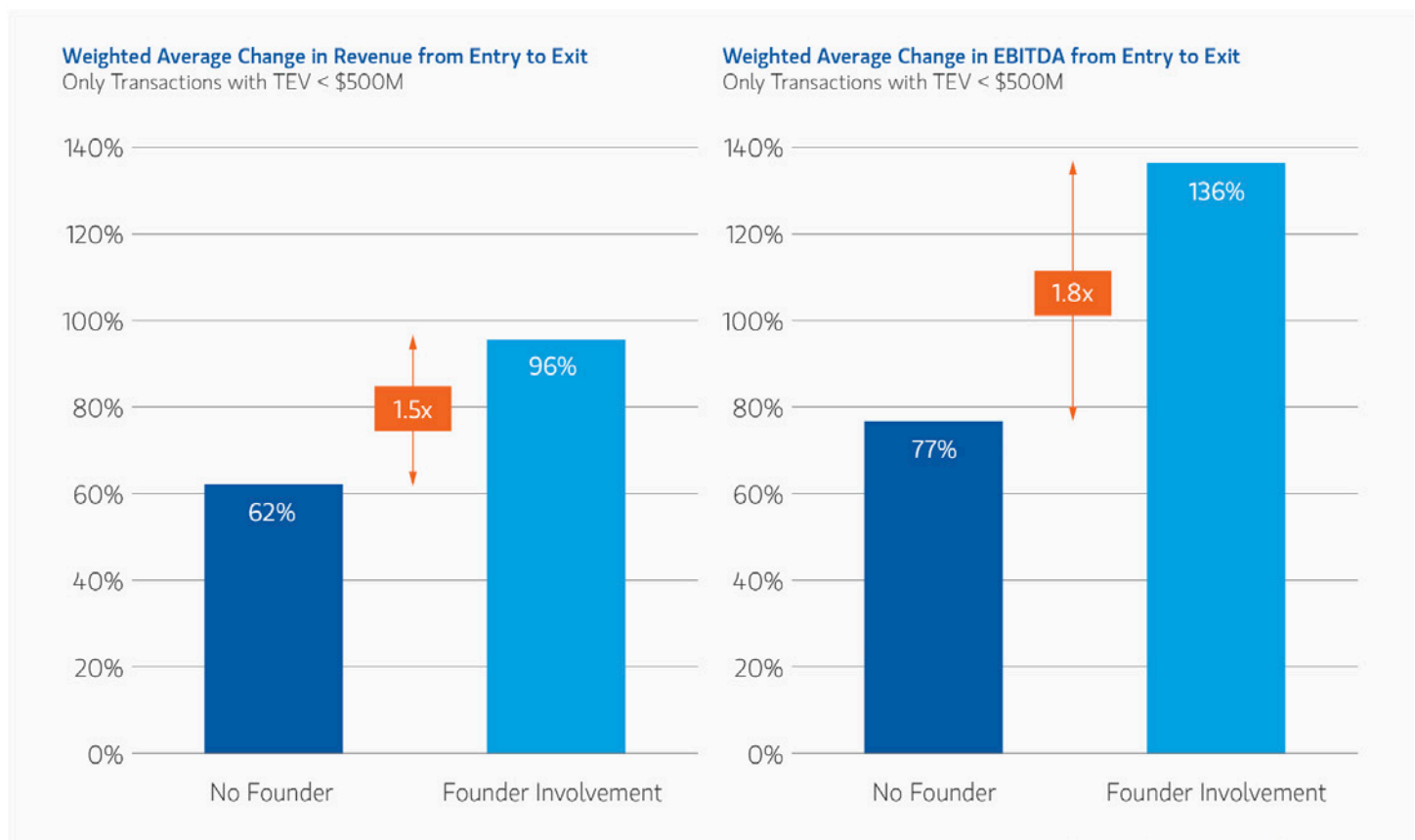
It's clear that these businesses can generate some strong results for both private equity backers and founders. A recent Morgan Stanley report, for example, found not only that mid-market private equity investments significantly outperformed larger-cap deals in revenue and EBITDA increases, but also that deals involving a founder did even better on both metrics. Those with a founder involved achieved around a 50% higher increase in revenue from entry to exit and 80% higher EBITDA growth than other mid-market deals.

The supply of these deals is also expected to grow further over the coming years as the large, baby boom generation reaches retirement, as the Morgan Stanley report outlines, with the proportion of the US population aged 65 or older projected to increase by 30% from 2020 to 2030. Founders in this group are likely to seek some form of ownership transition over

the coming years – and many of these businesses could make attractive private equity targets. However, they have different characteristics when compared with other companies and they therefore require a different approach if they are to achieve private equity value creation and growth targets. (See Figure 1)

**FIGURE 1**

**Middle market deals with founders involved have outperformed those without founders.**



*Source: MSIM database of transaction level information, including only U.S. deals and excluding Morgan Stanley transactions. Represents a sample of portfolio companies that report on EV, Revenue, EBITDA, Net Debt, Public/Private Company, with data as of June 30, 2023; MSIM analysis as of September 2023. Given the sample universe and size, there is potential for selection bias. Middle Market is defined as a transaction value (TEV) of \$500M or less. Founder involvement defined based on MS asset-level research at the time of transaction. Sample includes 129 middle market transactions—62 with founder involvement and 67 with no or unknown founder involvement. Analysis excludes outliers.*

## Distinguishing Features

There are four main areas where founder-owned businesses are often distinct from other kinds of companies, and these can affect the approach a private equity investor should take both before and after a deal.

1

### Leadership may need restructuring and/or strengthening.

The motivations for partnering with private equity can vary, from succession deals that require new management teams, through to the founder seeing scope for further growth but recognising the need for both capital and expertise to achieve this. Whether the founder intends to take money off the table and leave or to remain involved in the company's expansion, the leadership challenges in these transactions can often be more complex than in other deal situations. A common issue is that management team members wear several different hats in the organisation, so untangling the roles to create a clear governance and responsibility structure can be difficult. There may also be a need to upskill or train existing team members or to bring new capabilities to the leadership bench.

2

### Founders may have a personal attachment to the business.

Founders and family members are likely to be emotionally attached to their business. After all, they will have spent years—or even decades—building it. They are likely to want a new owner to continue looking after employees, some of whom may fear the changes to come. Private equity firms, therefore, need to take time to build trust with the management team and beyond to reassure employees that their investment and support will result in a more resilient, faster-growing business.

3

### Not all founder-owned businesses will be open to change.

Improvements to the business clearly need to happen at a rapid pace under private equity ownership. Firms, therefore, need to understand how ready the organisation is for change. One issue we see commonly in founder-owned businesses is a lack of structured investment in skills and people development. While this can be remedied, it can mean there is less of an understanding among staff of why change is necessary and what that could entail. Potential private equity investors need to understand whether there is fear of or resistance to change, where in the organisation this resides and the extent to which they can bring people along with them in a change management programme.

4

### True potential may be well hidden.

In many founder-owned businesses, operational and financial information is not readily available, which can make it challenging for private equity investors to identify and then capture a company's true potential. Few founder-owned businesses, for example, have the processes, systems or KPI performance data needed to provide a full picture, while the metrics they use may not be focused on creating value. These companies can also often lack the skilled resources to gather this kind of information.

All this means there is a great deal of heavy-lifting required to first, determine the true potential of a founder-owned business and then, to realise it during a typical private equity holding period.

## Before The Deal – Approaches That Build Trust and Identify Potential

As we've noted, gathering the necessary information from a founder-owned business can be challenging. However, it is still possible to look under the hood of a company to understand its true potential before a deal is completed.

- **Bring in the operators – early on.**

This is where in-house or third-party advisory people with operational expertise, combined with experience of working alongside founder-owned businesses, can be invaluable. It's vital that these advisors are people who have walked factory floors and who can identify where inefficiencies, such as bottlenecks, lie. They should also be able to deploy evidence-based solutions so they can start to build trust between the potential private equity backer and the founder-owned business team.

We've seen how powerful this can be. In one example, we carried out operational due diligence on a potential deal for a private equity firm where the company had a production backlog of \$80 million. With the facility running at a less than \$10 million monthly output, there was a clear need for change. After sharing the process improvement plan, which identified the potential for efficiency gains, a daily management approach to achieve them, and a picture of the team's openness to make improvements, the private equity firm and founder-owned business engaged us to implement the plan once the deal had been completed. The result was that the facility increased monthly output to \$13 million in the space of just four months.

Yet just as important were that the private equity partner could see the company's true potential clearly ahead of the deal, that it could work collaboratively to clear the backlog, and that the process built a sense of belief in the team that the partnership was a good fit for both sides.

- **Be clear about capacity for change.**

The kind of initiative outlined above can help private equity firms understand the level of change-readiness that exists in the business before completing the deal. This is a key item for truly understanding what the firm is buying because, in a minority of cases, resistance to change among key personnel or the broader employee base may be intractable. It's far better to know this at a point at which an investor can decide to walk away from the deal.

However, in our experience, provided that the firm and its advisers can gain the trust and confidence of management and can communicate in a relatable way that uses facts (as opposed to opinions) to determine where change is needed, most businesses can bring employees with them to effect change and improvements.

Indeed, experienced operators can identify where the issues are and address them as a win-win when devising an improvement plan. We saw this in a recent project, where a prospective private equity buyer engaged us during due diligence to advise on improvements for a food safety assessment business. Once it was complete, the management team requested a copy of the report so it could start work on improving – a clear signal of the company's openness to change.

## After The Deal – Approaches That Achieve True Potential

Many founder-owned businesses have not had structured processes or plans for growth. They may, for example, have developed a great product and the business has simply responded to some of the demand for it. However, in these situations, the business is unlikely to be achieving full growth potential because of a lack of capital and/or a plan that creates the foundations for future growth. Many founder-owned businesses will therefore need support to build a high-performing organisation and to add capability.

- **Align interests to accelerate change.**

Creating the right governance structures can help build capacity. Many founder-owned businesses grow at the pace set by the founder; private equity investors, meanwhile, clearly require fast-paced change and growth to ensure they meet their return objectives.

One way of aligning the expectations and interests of private equity investors and management teams is to engage a third-party advisor to create independent timelines for transformation that are built on the facts before them. If engaging advisers to help implement change, they should be working together with board-level decision-makers and creating a steering committee that reports back regularly to the private equity backer. This provides a layer of separation between private equity and management to keep things moving in the right direction without the investor having to micro-manage.

- **Don't dictate, demonstrate.**

Simply devising a plan for improvement and then expecting teams to implement it is unlikely to generate much, if any, change. The people helping to implement change need to roll up their sleeves and work alongside the people at the point of impact, such as the management team and sometimes those on the factory floor, if they are to deliver benefits from actions within a short timeframe. This is also important for

building trust between the private equity firm and the management team and employees, while demonstrating what is possible so that change can be sustained over the long term.

- **Build institutional knowledge.**

We commonly encounter “tribal knowledge” among employees in founder-owned businesses. They are the sole keepers of know-how in the company since processes and procedures are frequently not formally documented. Yet this stifles growth - that knowledge can walk away and find a new job - and it makes it much more difficult to onboard and train new people. By helping to implement systems that are proven to be effective and that are written down, private equity firms can help businesses grow more quickly because it becomes easier to make new hires to expand capacity.

- **Consider the transition.**

Even if a founder is not exiting the business when the deal completes, many opt for a phased approach. The right advisers that have built trust with the management team can facilitate and smooth a transition to new leadership, while also identifying any training or coaching that may be needed to ensure the company has the right skills mix for growth. It's also worth keeping in mind that the arrival of new leadership can help bring about further change and improvements.

A recent assignment we have worked on demonstrates the value of laying the foundations for growth and working alongside people to generate lasting change. We helped a founder-owned business structure a plan for growth through M&A. However, the first phase was not seeking out acquisitions; rather, it was working collaboratively with the management team to create the right company, site and leadership structures that would underpin growth while also strengthening the team and building on marketing strategies. Other capacity-building initiatives included putting in place a robust talent management strategy to reduce staff turnover and establishing the right KPIs and reporting methodology to focus the business on value creation and growth. With all this implemented in the space of a few months, the company is now in a position to focus on its long-term strategy of acquiring up to 30 smaller businesses over the next five to seven years.

## The power of strong partnerships

There is significant untapped potential in most founder-owned businesses that, if unlocked, could generate attractive returns – to the benefit of private equity firms, founders and the companies themselves.

Achieving this requires relationships built on trust between founders and their employees, private equity backers and any advisers hired to produce and implement an improvement and growth plan. This is why it is vital to get the right advice and ongoing support from seasoned operators with a long history of working successfully with founder-owned businesses. This is true before sealing the deal – so that the private equity house understands clearly what it is buying and both investor and management teams know what they need to implement – and after the transaction is complete so they can translate the plan into fast-paced action for improvement.

## Need help? Contact us today!



**André Smaal**

Vice President, Europe

✉ [asmaal@tbmcg.com](mailto:asmaal@tbmcg.com)

Learn More About   
TBM's Private Equity Practice

## Speed wins every time.

TBM specialises in operations and supply chain consulting for manufacturers and distributors. We accelerate operational performance to make you more agile and help you accelerate business performance 3–5x faster than your peers.



[tbmcg.co.uk](http://tbmcg.co.uk)

Follow us



42 - 44 Nottingham Road  
Mansfield, NG18 1BL, UK  
O: Central Europe: +351 918 168 607  
O: Poland +48.605.202.885